Salt Sustainable Income Fund Fact Sheet – May 2022

Manager Profile

Salt Funds Management is a boutique investment management firm wholly owned by its employees which specialises in actively seeking to maximise returns while managing the risks of the investment. Salt examines investments for their environmental and social impact as well as the quality of their governance.

Investment Strategy

The Fund aims to provide a gross fixed quarterly income (after fees and expenses but before tax) in excess of bank deposit rates, along with a positive return on capital on a rolling three-year basis. Deposit rates are proxied by the NZ Bank Bill Index.

The Fund targets a diversified mix of growth and defensive assets, with a focus on securities with strong Environmental, Social and Governance credentials & reliable income generation. The Fund's strategy is to invest in a quality asset mix with an aim to provide regular, sustainable income and a positive return on capital. At times the value of the fund will fluctuate in line with listed market developments, but the primary focus is enhanced income and thus, shorter-term variability or volatility is an expected feature.

Income is prioritized above capital gain in the fund, nevertheless, the allocation to both growth and yielding assets allows for both objectives to operate over the medium- and longer-term horizons.

Fund Facts at 31 May 2022

Benchmark	Bank deposit rates (BNZBIL Index)
Fund Assets	$45.2 million
Inception Date	19 June 2021
Portfolio Manager	Greg Fleming
Current yield to 31/10/22	4.00% per annum

Unit Price at 31 May 2022

Application	0.9244
Redemption	0.9206

Investment Guidelines

Sector	Target	Range
New Zealand Fixed Interest	20%	0% – 40%
International Fixed Interest	15%	0% – 40%
Australasian Shares	30%	15% – 45%
Global Listed Property	15%	0% – 30%
Global Listed Infrastructure	15%	0% – 30%
Cash or cash equivalents	5%	0% – 20%

Fund Allocation at 31 May 2022

New Zealand Fixed Interest	0%
International Fixed Interest	19%
Australasian Shares	34%
Global Listed Property	25%
Global Listed Infrastructure	18%
Cash or cash equivalents	4%

Fund Performance to 31 May 2022

Period	Fund Return	Benchmark Return
1 month	-2.78%	0.13%
3 months	-3.50%	0.32%
6 months	-5.42%	0.53%
Since inception	-4.13%	0.73%

Performance is after all fees and does not include imputation credits or PIE tax. Past performance is not a reliable indicator of future performance and no representation or warranty, express or implied, is made regarding future performance.

Top Individual Holdings at 31 May 2022

Goodman Property Trust	Spark NZ
Cash	Property for Industry
Kiwi Property Group	Argosy Property Trust
Precinct Property	Stride Property & Stride Invest Mgmt
Fisher & Paykel Healthcare	Vital Healthcare Property Trust

Holdings stated as at 31.05.22, excludes consolidated International Fixed Interest Fund component.

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Salt Sustainable Income Fund Distribution increased in May

Due to increasing component yield income projected for the next six-month period, we are pleased to have been in the position to announce that from the Salt Sustainable Income Fund distribution on 9 May, the distribution rate increased by 0.25% to reflect an annual distribution target of 4.00%. The cents per unit (cpu) value of the rate increase was communicated to investors, based on the Fund's Unit Price on 1 April 2022. This rate will be held until it is reviewed on 31 October in the light of intervening asset market developments, and ahead of the November 2022 distribution payment. Given higher yields, we are optimistic on the distribution path.

Market Commentary

- Global equity markets ended May broadly flat, though it was a roundabout journey getting there with significant intra-month volatility. Key macro risks remain at the forefront, including war in Ukraine, weak data out of China, and further tightening in monetary policy. Markets still lack a catalyst for a change in sentiment.
- Central banks continue to play catch-up with inflation, which is contributing to growing risks to growth, though those risks remain greater in Europe than the United States. Labour markets remain tight but negative real wage growth continues to squeeze household incomes. Margins are coming under pressure, especially for consumer-facing companies, with pricing power becoming an increasingly important factor in relative equity performance.
- In the United States the FOMC's 50bp hike in the Fed funds rate during the May month was well-signalled. Hawkish commentary from various FOMC participants and inflation data saw interest rate markets pricing in a series of larger hikes. In June, the Fed hiked 75bps, validating market expectations, with more to come.
- US headline inflation came in higher than expected at 8.6% y/y. Growth risks increased over the month which saw FOMC commentary becoming more hawkish.
- The war in Ukraine continues unabated with no sign and little hope of an imminent resolution. Positioning of both sides appears incompatible with a diplomatic solution.
- European consumer confidence improved in May, though remains low. Business confidence remains resilient. This will give the European Central Bank confidence in moving ahead with its "pre-announced" intentions to deliver a first interest rate increase in July, end asset purchases during the third quarter of the year and exit negative interest rates by the end of Q3 2022.
- The Reserve Bank of Australia raised interest rates for the first time this cycle at the May meeting, raising the cash rate 25bps to 0.35%. Labour market and activity trends during 2022 thus far suggest solid economic fundamentals amid building inflationary pressures. We expect ongoing interest rate increases and a step up to 50bp hikes was seen in the first meeting in June, to 0.85%.

Salt Sustainable Income Fund Commentary

The Sustainable Income Fund again declined moderately in **May**, with a negative monthly return of -2.78% (after fees). Difficult international and domestic conditions persisted, and within this fund's component asset classes, domestic assets (excluding Cash) contributed negatively. Modest positive returns from Global Infrastructure and Fixed Interest were unable to offset the downward pressure from the NZ assets. In a continuation of resilient relative performance, the Salt Sustainable Global Infrastructure Fund, showed a 2.1% gain in May and accounted for 0.40% of the Sustainable Income Fund's overall return. The Hunter PIMCO Global Bond Fund was little changed for the month and contributed +0.08%. The Salt NZ Dividend Appreciation Fund detracted -1.65% in April, while a comparable negative portfolio impact last month was delivered by the Salt Enhanced Property Fund, contributing -1.59% of the -2.78% overall decline.

Over the rolling three-month period to 31 May and since Inception, the fund's decline has been -3.50% and -4.13%, respectively (after fees.) This is fully explained by the concentrated weakness in both bond and equity markets this year. The bond components of the portfolio have dragged on bond valuation returns as interest rates rose; however the yield received from those bond investments is also rising rapidly, and will support the Sustainable Income Fund's forward distribution path. This is characteristic of a transition period from a low- to a mid-level interest rate regime.

Although the capital growth element previously built up in this fund in late 2021 has been more than reversed by recent market developments, the income level has been enhanced. We anticipate the capital growth aspect of the Fund to resume gradually once international conditions stabilize. As the primary objective of the Salt Sustainable Income Fund is to invest in quality sustainable yield payers, minimizing short-term capital price fluctuation is secondary.

Given the extraordinary weakness in global bond markets, the Global Fixed Interest Fund showed benefits of active management in May, with a fund return of +0.23%, well ahead of the benchmark's performance of -0.14%. This contributed 0.08% to the Salt Sustainable Income Fund for the month as bond yields surged higher and credit spreads widened (reflecting greater expected economic weakness ahead.) The bond portfolio outperformed its benchmark by 0.16% for the three-month period and by 0.56% for the year, reflecting underweight duration and cautious credit positioning. However, the absolute return from the global bond benchmark index of -5.0% for three months, and -6.9% for the year, shows the severity of the current weakness in the international fixed interest fund arena. The relatively low portfolio weighting to this sector in the Salt Sustainable Income Fund limited the impact overall. PIMCO continues to forecast moderating but above trend growth. PIMCO expect that the Russia / Ukraine conflict will continue to create volatility but that inflation will ultimately be the main driver of central bank actions and that central banks will aggressively continue with their signalled tightening plans for the time being.

Accordingly, PIMCO are maintaining a cautious view towards both interest rates and corporate credit, with a focus on relative value positions and diversified alpha strategies. Within the broader risk exposures, they maintain tactical tilts that aim to provide benefits across a variety of scenarios given the increasingly volatile environment. The big unknown is whether Central Banks can successfully engineer a soft landing or will a recession be required to curb inflation expectations.

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The domestic equity components made negative contributions to the Salt Sustainable Income Fund's return, though both funds continue to outperform their respective benchmarks. At -1.65%, the largest component of the Sustainable Income Fund's monthly decline was attributable to the Salt NZ Dividend Appreciation Fund (DAF.) The Salt Enhanced Property Fund made a marginally smaller negative contribution of -1.59% for the month.

The NZ dividend-focussed equity components of the portfolio are yet to make a sustained positive portfolio impact, and we expect them to retain a downward impact on overall Income Fund performance until a catalyst emerges for equity market recovery. Nevertheless, the income yield provided by these assets is important to the Fund's distribution level.

The pricing in of rising interest rates has supressed equity returns in the last several months, but the income yield characteristics of the equity, property and infrastructure sectors continue to strongly support their inclusion at substantial weightings in the fund. By contrast, bond yields, while now higher, are not quite at the level required to make a positive contribution and the risk of mark-to-market valuation declines on many bonds remains.

Nevertheless, given the rapid run-up in global bond yields which has intensified into June, the point at which additional Fixed Income exposure may be added to the Salt Sustainable Income Fund is coming closer.

After some short-term softness in NZ economic data and pullback in activity due to the Omicron variant, recent consumer and labour data indicate that the outlook for the New Zealand economy remains solid. The inflation outlook has heated up as well, which will keep the RBNZ on track for further rate hikes this year. We expect a 50bp hike in July, after which the RBNZ will likely slow the pace of rate hikes to 25bps for a terminal rate of 3.0-3.5%.

Internationally, major central banks are now communicating the desirable course of concluding several meaningful interest rate increases, sufficient to anchor inflation expectations, and this will unnerve markets at times. While the resultant volatility requires fortitude from investors, the objective of securing an inflation-resilient income level now means that equity market fluctuations and corrections over the near-term are inevitable. Over the medium-term, moderate capital gains in addition to income advantages are still expected.

Greg Fleming

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